In the Supreme Court of the United States

OCTOBER TERM, 1944

ESTATE OF HENRY H. ROGERS, DECEASED, ... [illegible]

INDEX

CITATIONS

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No. 618

ESTATE OF HENRY H. ROGERS, DECEASED; ALBERT STICKNEY AND CENTRAL HANOVER BANK AND TRUST COMPANY, AS SURVIVING EXECUTORS OF THE LAST WILL AND TESTAMENT OF HENRY H. ROGERS, DECEASED, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 23–39) is reported in 1 T. C. 629. The opinion of the Circuit Court of Appeals (R. 103–105) is reported in 143 F. 2d 695.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 24, 1944 (R. 105). The petition for a writ of certiorari was filed on

October 21, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Where the executors of decedent's estate, having made an installment sale within the meaning of Section 44 (b) of the Revenue Act of 1936, later transfer some of the installment obligations from the estate to various trusts created under the will of the decedent and also transfer other installment obligations to an escrow agent for a residuary legatee, whether the installment obligations have thereby been "distributed, transmitted, sold, or otherwise disposed of" within the meaning of Section 44 (d).

2. Whether the capital gain resulting from the installment sale may be deducted from the gross income of the estate under Section 162 (c) as an amount of estate income "properly paid or credited during such year" to the residuary legatees.

3. Whether 60% or 80% of the gain from the installment sale of the stock in question should be taken into account in computing net income under Section 117 (a). This depends upon whether the period during which the installment obligations were held may be tacked on to the period during which the stock was held.

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 44. INSTALLMENT BASIS.

*   *   *   *   *

(d) *Gain or loss upon disposition of installment obligation.*—If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (1) in the case of satisfaction at other than face value or a sale or exchange—the amount realized, or (2) in case of a distribution, transmission, or disposition otherwise than by sale or exchange—the fair market value of the obligation at the time of such distribution, transmission, or disposition. Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received. The basis of the obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full. This subsection shall not apply to the transmission at death of installment obligations if there is filed with the Commissioner, at such time as he may by regulation prescribe, a bond in such amount and with such sureties as he may deem necessary, conditioned upon the return as income, by the person receiving any payment on such obligations, of the same proportion of such payment as

would be returnable as income by the decedent if he had lived and had received such payment.

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

* * * * *

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

* * * * *

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

* * * * *

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or

credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

STATEMENT

The facts found by the Tax Court as stipulated (R. 24, 51–99) which are involved in this appeal may be summarized as follows:

This proceeding was maintained by the surviving executors of Henry H. Rogers who died on July 25, 1935, a resident of the State of New York. Among the assets of the estate were about 24,000 shares of common stock of the Virginian Railway, which had a fair market value at the date of death of about $1,400,000. (R. 24.) The executors sold the stock and received about $809,000 in cash and collateral trust notes of $2,400,000 principal amount in payment. The collateral trust notes had a fair market value equal to their face value. (R. 26.) Since the cost basis of the stock was about $1,400,000 (the value at the date of decedent's death), the executors derived a gain of about $1,700,000. The executors treated the sale as an installment sale and reported the gain on the installment basis, which the Commissioner questioned in his deficiency notice. (R. 26–27.) The Tax Court decided that the sale was an installment sale (R. 27), and no appeal was taken by the Commissioner from that part of the Tax Court's decision.

During the taxable year 1937, and about ten months after receiving the collateral trust notes, the executors transferred some of them in the amount of $1,250,000 to themselves as trustees of various residuary trusts under the will and an additional $250,000 of the notes to a bank as escrow agent for a residuary legatee. (R. 30.) Under these circumstances, the Commissioner argued before the Tax Court that the executors had "distributed, transmitted, sold or otherwise disposed of" installment obligations in the amount of $1,500,000 in the year 1937, and that the proportionate part of the gain deferred upon the installment sale should have been reported by the estate under the terms of Section 44 (d) of the Revenue Act of 1936. (R. 31–32.) The Tax Court upheld the Commissioner on this issue.

The executors contended that they were entitled to an offsetting deduction under Section 162 (c) of the Revenue Act of 1936 upon the ground that the income so taxed to the estate was "properly paid or credited during such year" to the residuary legatees. (R. 34–35.) But the Tax Court decided that there had been a distribution of corpus, not of income, and that the executors were not entitled to a deduction under Section 162 (c). (R. 38.)

The final argument made by the executors befor the Tax Court was that 60% of the gain should be taken into account under the terms of Section 117 (a) rather than 80%, because the pe-

riod during which the installment obligations (collateral trust notes) were held should be added to the period during which the railway company stock was held. (R. 38.) The Tax Court held that the 80% rate applied because only the period during which the stock was held should be taken into consideration under the statute. (R. 39.)

The executors appealed to the Circuit Court of Appeals, which affirmed the decision of the Tax Court. (R. 105.)

ARGUMENT

1. Section 44 (d) of the Revenue Act of 1936, *supra,* provides in part that if an installment obligation is distributed or otherwise disposed of, gain or loss shall result. The Commissioner determined and both the Tax Court and the court below decided that the executors had "distributed," or "disposed of" $1,500,000 of the installment obligations during the taxable year within the meaning of Section 44 (d). The transfer of the obligations from the accounts of the estate to the trust accounts, and from the estate to an escrow agent for a residuary legatee, as evidenced by the account filed in the Surrogate's Court and duly confirmed and approved by that court, would seem clearly to come within the meaning of "distributed, * * * or otherwise disposed of" in Section 44 (d). Congress used the words "distributed" and "disposed of" in the usual, ordinary and every-day meaning of those terms. See

Old Colony R. Co. v. *Commissioner,* 284 U. S. 552, 560 and cases cited. In the ordinary and every-day meaning of the words "distributed" and "disposed of," the decedent's estate distributed or disposed of the installment obligations when it transferred them to the various trust estates and to an escrow agent for a residuary legatee. The fact that the trustees happened to be the same persons as the executors is immaterial because they were not the same legal entities in the capacity of executors as they were in the capacity of trustees. See *Maguire* v. *Commissioner,* 313 U. S. 1, 7; *Helvering* v. *Gambrill,* 313 U. S. 11.

The Congressional Committee reports show that the purpose of Congress in enacting Section 44 (d) was to prevent evasion of taxes in connection with the transmission of installment obligations upon death, their distribution by way of liquidating or other dividends, or their disposition by way of gift, or in connection with similar transactions. The reports [1] expressly read in part:

> To prevent the evasion the subsection terminates the privilege of longer deferring the profit if the seller at any time transmits, distributes, or disposes of the installment obligations and compels the seller at that time to report the deferred profits.

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[1] H. Rep. No. 2, 70th Cong., 1st Sess., p. 16 (1939–1 Cum. Bull. (Part 2), 384, 394–395); S. Rep. No. 960, 70th Cong., 1st Sess., p. 24 (1939–1 Cum. Bull. (Part 2), 409, 425–426).

In this case the sellers (the executors of the decedent's estate) distributed or disposed of the installment obligations when they transferred the notes to themselves as residuary trustees of the decedent's estate and to the escrow agent for a residuary legatee. Therefore, under the statute they were compelled at that time to report the deferred profits.

While there are no authorities directly in point, there are several analogous cases which tend to support the decision of the court below. *Crane* v. *Helvering,* 76 F. 2d 99 (C. C. A. 2d); *Waddell* v. *Commissioner,* 102 F. 2d 503 (C. C. A. 5th); *Marshall* v. *United States,* 26 F. Supp. 580 (S. D. Cal.). The petitioners do not allege that there is a conflict between the decision of the court below and the decision of another Circuit Court of Appeals; but they do allege that the decision of the court below conflicts in principle with the following decisions of this Court: *Brewster* v. *Gage,* 280 U. S. 327; *Maguire* v. *Commissioner, supra; Helvering* v. *Gambrill, supra; Helvering* v. *Campbell,* 313 U. S. 15; *Helvering* v. *Reynolds,* 313 U. S. 428; and *Cary* v. *Commissioner,* 313 U. S. 441. Each of those cases involves substantially different facts from the instant case and none of those cases involves the application of Section 44 (d) of the Revenue Act of 1936 or the corresponding provision of another Revenue Act.

2. Section 162 (c) of the Revenue Act of 1936, *supra,* provides in part that the net income of the

estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that in the case of income received by estates of deceased persons during the period of administration of the estate, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee or beneficiary.

The purpose of the statute is plain. Income of an estate is taxable either to the beneficiary or to the estate. If the estate properly pays the income to a legatee or beneficiary, the estate is allowed a deduction for the amount so paid, but the amount so allowed as a deduction shall be included in the gross income of the legatee or beneficiary. In this case the income in question is in the form of a capital gain derived from the sale of stock by the executors. The will of the decedent contains no provision in regard to income of the estate during administration, but Article Twenty-third of the will expressly provides that capital gain shall be considered principal and not income. (R. 83.)[2]

Moreover, in their accounts filed with the Surrogate's Court the executors treated the payments as "Payments of Principal to * * * the Beneficiaries." (R. 90.) Also, the Tax Court found

[2] There is a clerical error in the opinion of the court below where the word "depreciation" (R. 104, par. 2, line 6), appears instead of "appreciation" (R. 83, line 10).

as a fact that the trustees did not report any income distributed in their tax return. (R. 35.) Under these circumstances, we think that both the Tax Court and the court below were justified in concluding that the decedent's estate was not entitled to a deduction under Section 162 (c), because they did not distribute any income of the estate *as income* to legatees or beneficiaries. Whatever they paid out they paid as principal, as shown by their accounts and by the language of the will and by the Surrogate Court's approval of their accounts.

The decision of this Court in *Burnet* v. *Whitehouse,* 283 U. S. 148, tends to support the decision of the court below. In that case the testator provided in his will for an annuity to his widow to be paid out of principal if income was not sufficient. In the taxable year income was available for the payment of the annuity. This Court held that even though the amount distributed by the trust was trust income, it was not taxable to the beneficiary because it was paid as corpus. In the instant case likewise the capital gain which the executors transferred to the several trusts was paid as corpus, not as income.

The petitioners allege that the decision of the court below is in direct conflict with the decision of this Court in *Helvering* v. *Butterworth,* 290 U. S. 365. (Pet. 8–9.) This Court decided a group of four cases in one opinion; since the trustee was allowed to deduct the amount of trust in-

come paid to the beneficiary in three out of the four cases, we assume that the petitioners rely upon the decision in those cases. In those cases the will gave the residue of the estate to trustees to pay the net income to the widow. The Government argued that since the widow had taken under the will in lieu of dower and had not yet received the value of her dower interest, the payments to the widow were not income under the rule of certain Circuit Court of Appeals decisions. This Court refused to accept the reasoning of those cases, and decided that the widow was a beneficiary within the meaning of the statute, to whom income was paid in that capacity. The instant case is substantially different in its facts. Under the will in this case, there is no provision for the payment of trust income to beneficiaries. The basis of the decision below lies in this critical fact. The decision does not rest, as assumed by taxpayer, upon any concept that income to the estate lost its character when transferred.

3. Section 44 (d) of the Revenue Act of 1936, *supra,* provides in part that any gain resulting shall be considered as resulting from the sale of the property in respect of which the installment obligation was received. Applying that clause of Section 44 (d) to the facts of this case, the gain resulting from the disposition of the installment obligations would be considered as resulting from the sale of the railway company stock. The purpose of that clause in Section 44 (d) is shown by

the Congressional Committee Reports,[3] which provide in part:

> This amendment to the House bill makes it clear that where the profit on the sale or exchange of property is returned on the installment basis by spreading the profit over the period during which the installment obligations are satisfied or disposed of, such profit shall be taken into account under the brackets set forth in section 117 of the bill *according to the period for which the original property sold was held rather than according to the period for which the installment obligations were held.* [Italics supplied.]

As both the Tax Court and the court below pointed out in their opinions, Congress did not intend to permit taxpayers entitled to the privilege of deferring the report of realized gain to drop into the lower brackets on the basis of the length of time the *installment obligations* were held. The gain was realized at the time of the sale and would have been taxable at that time in full but for the privilege granted of paying the tax as the unpaid installments were received. The gain "resulting" upon disposition of the installment obligations was the gain that had been realized upon the sale or exchange of a capital asset, namely, the railway company stock, and that as-

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[3] S. Rep. No. 558, 73d Cong., 2d Sess., p. 29 (1939-1 Cum. Bull. (Part 2) 586, 608); see also H. Conference Rep. No. 1385, 73d Cong., 2d Sess., p. 18 (1939-1 Cum. Bull. (Part 2) 627, 629).

set ceased to be held by the executors of the decedent's estate at the time of the sale. The applicable holding period was the length of time the stock was held.

The petitioners do not allege that the decision of the court below on this point is in direct conflict with the decision of any other court.

CONCLUSION

The decision of the court below is correct upon all three issues raised by the petition for a writ in this case. There is no conflict of decisions upon any one of the issues. The petition for certiorari should be denied.

Respectfully submitted.

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